Illinois Credit Union League

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VIA E-MAIL TRANSMISSION regcomments@ncua.gov

April 24, 2006

Ms. Mary Rupp, Secretary of the Board National Credit Union Administration 1775 Duke Street Alexandria, Virginia 22314-3428

Re: Part 715 Advance Notice of Proposed Rulemaking, Supervisory Committee Audits

Dear Ms. Rupp:

We are pleased to respond on behalf of our member credit unions to the National Credit Union Administration ("NCUA") Board's Advance Notice of Proposed Rulemaking ("ANPR") on whether and how to modify its Supervisory Committee audit rules in four discrete areas. The Illinois Credit Union League represents over 400 federal credit unions and federally insured state chartered credit unions.

A. Internal Control Assessment and Attestation.

Q1. Should part 715 require, in addition to a financial statement audit, an "attestation on internal controls" over financial reporting above a certain minimum asset size threshold?

As NCUA acknowledges, there is no statutory requirement mandating the imposition of an "attestation on internal controls" on credit unions. The statutes mandating such attestation for FDIC insured financial institutions and on public companies were enacted to address bank and thrift abuses in the 1980s and abuses involving public companies in the 1990s. We are not aware of any systematic financial abuse or misreporting of larger credit unions that would warrant imposition of the attestation requirement by NCUA. We believe that current regulations, regulatory examinations, and outside auditors provide sufficient evaluations on the effectiveness of internal controls.

Q2. What minimum asset size threshold would be appropriate for requiring, in addition to a financial statement audit, an "attestation on internal controls" over financial reporting, given the additional burden on management and its external auditor?

If NCUA imposes an "attestation on internal controls" requirement, the minimum asset size should not be less than the FDIC's \$1 billion minimum. NCUA should review the relative complexity of credit unions compared to banks and thrifts. If NCUA finds that the complexity of a \$1 billion credit union is substantially less than a \$1 billion bank or thrift, NCUA should adopt a greater minimum asset size. E.g., if NCUA determines that credit unions do not typically attain the complexity of a \$1 billion bank until credit union assets reach \$3 billion, the minimum asset size for credit unions should be \$3 billion.

Q4. Should management's assessments of the effectiveness of internal controls and the attestation by its external auditor cover all financial reporting, (i.e., financial statements prepared in accordance with GAAP and those prepared for regulatory reporting purposes), or should it be more narrowly framed to cover only certain types of financial reporting?

Since part 715 requires the credit unions that would be subject to an "attestation on internal controls" requirement to have a financial statement audit in accordance with GAAP, it is appropriate that the attestation requirement, if imposed by NCUA, should cover the financial reporting process over the annual audited financial statements.

Q5. Should the same auditor be permitted to perform both the financial statement audit and the "attestation on internal controls" over financial reporting, or should a credit union be allowed to engage one auditor to perform the financial statement audit and another to perform the "attestation on internal controls"?

If NCUA imposes an "attestation on internal controls" requirement, credit unions should be given alternative of (a) engaging the auditor performing the financial statement audit to perform the "attestation on internal controls" over financial reporting, or (b) engaging a separate auditor to perform the "attestation."

Auditors performing the financial statement audit acquire substantial knowledge of a credit union's operations and financial reporting. Use of the same auditor can result a more effective "attestation on internal controls" and with less cost to the credit union.

However some credit unions employ a separate auditing firm to perform "internal audit" procedures during the year. If the "internal audit" procedures are performed under the AICPA's attestation standards for agreed-upon procedures, the firm is considered independent under AICPA standards. If the firm is considered independent under AICPA standards, a credit union should be allowed to engage the firm performing the "internal audit" procedures to perform the "attestation on internal controls." The firm performing the "internal audit" procedures will often have greater knowledge of the credit union's

internal controls over reporting than the firm performing the external financial audit.

Q6. If an "attestation on internal controls" were required of credit unions, should it be required annually or less frequently?

The "attestation on internal controls" should not be required annually unless there are significant changes in management, procedures or products, or there are significant issues at the credit union. Absent such changes or issues the required frequency should be every three years.

Q7. If an "attestation on internal controls" were required of credit unions, when should the requirement become effective?

Given the extensive documentation of internal controls required for an "attestation on internal controls" and the substantial cost of the initial attestation, the requirement should become effective no earlier than 36 months after the requirement is adopted.

B. Standards Governing Internal Control Assessments and Attestations.

Q8. If credit unions were required to obtain an "attestation on internal controls," should part 715 require that those attestations, whether for a natural person or corporate credit union, adhere to the PCAOB's AS 2 standard that applies to public companies, or to the AICPA's revised AT 501 standard that applies to non-public companies?

Credit unions should adhere to AICPA's revised AT 501 standard. AT 501 is being revised to reflect guidance from PCOAB's AS 2 that is applicable, appropriate and useful for examinations of internal control on nonissuers and examinations of internal control on financial institutions and other regulated entities.

Q9. Should NCUA mandate COSO's Internal Control--Integrated Framework as the standard all credit union management must follow when establishing, maintaining and assessing the effectiveness of the internal control structure and procedures, or should each credit union have the option to choose its own standard?

While the COSO report is the most commonly recognized standard, it was developed for public companies and may impose an unnecessary burden on credit unions. NCUA should consider developing a standard appropriate for credit unions and provide credit unions with an opportunity to comment on the proposed standard.

C. Qualifications of Supervisory Committee Members.

Q10. Should Supervisory Committee members of credit unions above a certain minimum asset size threshold be required to have a minimum level of experience or expertise in

credit union, banking or other financial matters? If so, what criteria should they be required to meet and what should the minimum asset size threshold be?

We note the FDIC's similar audit committee requirement cited by NCUA is "banking or related financial management expertise" and applies to banks with assets of more than \$3 billion. Since the supervisory committee must be appointed from the credit union's members, even very large credit unions may have few if any members with expertise in banking or related financial management. If NCUA adopts an expertise requirement for larger credit unions, the standard should be that set forth in question 10 (experience or expertise in credit union, banking or other financial matters) and the credit union's board should be allowed to determine the appropriate level of expertise or experience. The minimum asset size should be no less than FDIC's minimum, \$3 billion.

Q11. Should Supervisory Committee members of credit unions above a certain minimum asset size threshold be required to have access to their own outside counsel? If so, at what minimum asset size threshold?

Supervisory committees should have access to legal advice when necessary. However, credit unions need to be protected from a supervisory committee incurring substantial legal fees when consulting a separate outside counsel is unnecessary. We do not believe there is a need for a rule regarding supervisory committee access to outside counsel. FDIC requires access of the audit committee to their own outside counsel for banks with assets greater than \$3 billion. If NCUA does adopt such a requirement, the minimum asset size threshold should be the FDIC minimum, \$3 billion.

Q12. Should Supervisory Committee members of credit unions above a certain minimum asset size threshold be prohibited from being associated with any large customer of the credit union other than its sponsor? If so, at what minimum asset size threshold?

This FDIC prohibition on large customers (applying to banks with assets greater than \$3 billion) seems more appropriate to banks in that even large credit unions rarely have "large customers." If NCUA issues proposed rulemaking the term "large customer" would need to be defined and the minimum asset size should be the FDIC minimum, \$3 billion.

Q13. If any of the qualifications addressed in questions 10, 11 and 12 above were required of Supervisory Committee members, would credit unions have difficulty in recruiting and retaining competent individuals to serve in sufficient numbers?

With respect to Question 10's qualifications, credit unions are limited in their recruitment of supervisory committee members by the requirement that the committee members must be within the field of membership of the credit union. In addition supervisory committee members may not be paid. Banks commonly pay their audit committees and have no common bond limitations in recruiting

committee members. NCUA should give careful consideration to these differences before adopting FDIC's qualification requirements.

D. Independence of State-Licensed Compensated Auditors.

Q14. Should a State-licensed, compensated auditor who performs a financial statement audit and/or "internal control attestation" be required to meet just the AICPA's "independence" standards, or should they be required to also meet SEC's "independence" requirements and interpretations?

With respect to audits of credit unions, auditors should be required to meet only the AICPA's independence standards. These standards have been updated to incorporate the relevant SEC requirements that are applicable and appropriate for nonissuers and financial institutions and other regulated entities. The SEC standards that are not relevant to regulated entities should not be imposed on credit unions.

Part 715 (12 CFR 715.9(a)) imposes independence standards on a compensated auditor that differ in some respects from the AICPA's independence standards. Part 715 should be amended to clarify that with respect to financial statement audits and internal control attestation engagements, AICPA's independence standards apply in lieu of the standards set forth in §715.9(a).

E. Audit Options, Reports and Engagements.

Q15. Is there value in retaining the "balance sheet audit" in existing Sec. 715.7(a) as an audit option for credit unions with less than \$500 million in assets?

The balance sheet audit should be retained. Since an auditor cannot give an opinion on the operating statements of a credit union unless both the beginning and year-end balance sheet have been audited, balance sheet audits are particularly appropriate in the first year of a change to a financial statement audit from an audit based on the Supervisory Committee Guide or a report on examination of internal control over call reporting.

Q16. Is there value in retaining the "Supervisory Committee Guide audit" in existing Sec. 715.7(c) as an audit option for credit unions with less than \$500 million in assets?

NCUA had posed this question prior to the last revision of the Supervisory Committee Guide and it is troubling that NCUA is asking this question again. The Supervisory Committee Guide and the related forms provide invaluable assistance for supervisory committees of smaller credit unions and the Supervisory Committee Guide audit is the only option that does not require a CPA to perform the audit. Conscientious supervisory committees of smaller credit unions can perform an adequate audit through the use of the Supervisory Committee Guide and somewhat larger credit can employ non-CPAs with

substantial experience in credit union accounting and regulations to perform Supervisory Committee Guide audits. Removing this option would impose an undue and in some cases unsustainable financial burden on a substantial number of credit unions.

- 17. Should part 715 require credit unions that obtain a financial statement audit and/or an "attestation on internal controls" (whether as required or voluntarily) to forward a copy of the auditor's report to NCUA? If so, how soon after the audit period-end?
- 18. Should part 715 require credit unions to provide NCUA with a copy of any management letter, qualification, or other report issued by its external auditor in connection with services provided to the credit union? If so, how soon after the credit union receives it?

NCUA should continue to be provided with the financial statement audit and "attestation on internal controls" for its review in conjunction with the credit union's examination. NCUA has not indicated why this procedure should be changed. If NCUA does determine that the auditor's reports must be sent to NCUA, the materials should be limited to reports provided by the auditor to the Supervisory Committee or Board of Directors and should be sent to the NCUA within 120 days of the audit period-end.

19. If credit unions were required to forward external auditors' reports to NCUA, should part 715 require the auditor to review those reports with the Supervisory Committee before forwarding them to NCUA?

The Supervisory Committee should determine whether the auditor must review the reports with them prior to forwarding to NCUA.

20. Existing part 715 requires a credit union's engagement letter to prescribe a target date of 120 days after the audit period-end for delivery of the audit report. Should this period be extended or shortened? What sanctions should be imposed against a credit union that fails to include the target delivery date within its engagement letter?

The 120-day target date is appropriate. Sanctions should not be imposed against a credit union failing to include the target date unless the audit report is not delivered within 120 days. NCUA should amend part 715 to allow requests for an extension of the 120-day period when there are extenuating conditions.

21. Should part 715 require credit unions to notify NCUA in writing when they enter into an engagement with an auditor, and/or when an engagement ceases by reason of the auditor's dismissal or resignation? If so in cases of dismissal or resignation, should the credit union be required to include reasons for the dismissal or resignation?

Credit unions should not be required to notify NCUA in writing regarding the engagement with an auditor or change in auditors, but should retain all

engagement letters for review by NCUA during NCUA's examination. NCUA should be notified of the resignation of an auditor from an engagement and the reasons for the resignation.

22. NCUA recently joined in the final Interagency Advisory on the Unsafe and Unsound Use of Limitation of Liability Provisions in External Audit Engagement Letters, 71 FR 6847 (Feb. 9, 2006). Should credit union Supervisory Committees be prohibited by regulation from executing engagement letters that contain language limiting various forms of auditor liability to the credit union? Should Supervisory Committees be prohibited from waiving the auditor's punitive damages liability?

Limitations on auditor liability described in the final Interagency Advisory should be prohibited. Waiver of punitive damages may be more acceptable but provisions providing for credit union indemnification of external auditors for third party punitive damages should be prohibited.

We appreciate the opportunity to respond to NCUA's ANPR on Supervisory Committee audits. We will be happy to respond to any questions regarding these comments or otherwise discuss our concerns with agency staff.

Very truly yours,

ILLINOIS CREDIT UNION LEAGUE

By: Cornelius J. O'Mahoney Senior Technical Specialist

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